

STATE OF CALIFORNIA  
**Budget Change Proposal - Cover Sheet**  
DF-46 (REV 07/17)

Fiscal Year 2018-19	Business Unit 0845	Department California Department of Insurance	Priority No.
Budget Request Name 0845-008-BCP-2018-GB		Program 0520 – Regulation of Insurance Companies and Insurance Producers	Subprogram 0520028 – Licensing

Budget Request Description

Surplus Line Brokers: Surplus Line Advisory Organization (AB 1641)

Budget Request Summary

The California Department of Insurance (CDI) is requesting an increase in Special Fund expenditure authority of \$196,000 in Fiscal Year (FY) 2018-19 and \$189,000 in FY 2019-20 and ongoing to support one (1.0) position to comply with the mandates of Assembly Bill (AB) 1641 (Chapter 477, Statutes of 2017).

Requires Legislation <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	Code Section(s) to be Added/Amended/Repealed	
Does this BCP contain information technology (IT) components? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No <i>If yes, departmental Chief Information Officer must sign.</i>	Department CIO	Date

For IT requests, specify the project number, the most recent project approval document (FSR, SPR, S1BA, S2AA, S3SD, S4PRA), and the approval date.

Project No.                      Project Approval Document:                      Approval Date:

If proposal affects another department, does other department concur with proposal? ☐ Yes ☐ No  
*Attach comments of affected department, signed and dated by the department director or designee.*

Prepared By Clayton Hallford	Date 1/10/2018	Reviewed By Justin Smith	Date 1/10/2018
Department Director Julia B. Cross	Date 1/10/2018	Agency Secretary N/A	Date

**Department of Finance Use Only**

Additional Review: ☐ Capital Outlay ☐ ITCU ☐ FSCU ☐ OSAE ☐ CALSTARS ☐ Dept. of Technology

PPBA	Original Signed By Tiffany Garcia	Date submitted to the Legislature 1.10.18
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**Fiscal Summary**  
(Dollars in thousands)

BCP No. 0845-008-BCP-2018-GB	Proposal Title Surplus Lines Brokers: Surplus Line Advisory Organization	Program 0520
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Personal Services	Positions			Dollars		
	CY	BY	BY + 1	CY	BY	BY + 1
Total Salaries and Wages <sup>1</sup>	0.0	1.0	1.0	\$0	\$116	\$116
Total Staff Benefits <sup>2</sup>				0	53	53
<b>Total Personal Services</b>	0.0	1.0	1.0	\$0	\$169	\$169

**Operating Expenses and Equipment**

General Expense	\$0	\$7	\$1
Printing	0	0	0
Communications	0	1	1
Postage	0	0	0
Travel-In State	0	0	0
Travel-Out of State	0	1	1
Training	0	1	1
Facilities Operations	0	9	9
Utilities	0	0	0
Consulting & Professional Services: Interdepartmental <sup>3</sup>	0	0	0
Consulting & Professional Services: External <sup>3</sup>	0	2	2
Data Center Services	0	0	0
Information Technology	0	6	5
Equipment <sup>3</sup>	0	0	0
Other/Special Items of Expense: <sup>4</sup>			
<b>Total Operating Expenses and Equipment</b>	\$0	\$27	\$20
<b>Total State Operations Expenditures</b>	\$0	\$196	\$189

Fund Source	Item Number					
	Org	Ref	Fund			
General Fund						
Special Funds <sup>5</sup>	0845	001	0217	\$0	\$196	\$189
Federal Funds						
Other Funds (Specify)						
Reimbursements						
<b>Total Local Assistance Expenditures</b>				\$0	\$0	\$0

Fund Source	Item Number					
	Org	Ref	Fund			
General Fund						
Special Funds <sup>5</sup>						
Federal Funds						
Other Funds (Specify)						
Reimbursements						
<b>Grand Total, State Operations and Local Assistance</b>				\$0	\$196	\$189

<sup>1</sup> Itemize positions by classification on the Personal Services Detail worksheet.<sup>2</sup> Provide benefit detail on the Personal Services Detail worksheet.<sup>3</sup> Provide list on the Supplemental Information worksheet.<sup>4</sup> Other/Special Items of Expense must be listed individually. Refer to the Uniform Codes Manual for a list of standard titles.<sup>5</sup> Attach a Fund Condition Statement that reflects special fund or bond fund expenditures (or revenue) as proposed.

(Whole dollars)

### Salaries and Wages Detail

## Staff Benefits Detail

<sup>1</sup> Use standard abbreviations per the Salaries and Wages Supplement. Show any effective date or limited-term expiration date in parentheses if the position is not proposed for a full year or is not permanent, e.g. (exp 6-30-13) or (eff 1-1-13)

**Note: Information provided should appear in the same format as it would on the Changes in Authorized Positions.**

<sup>2</sup> If multiple programs require positions, please include a subheading under the classification section to identify positions by program/element.

<sup>3</sup> Totals must be rounded to the nearest thousand dollars before posting to the Fiscal Summary.

# Supplemental Information

(Dollars in thousands)

BCP No. 0845-008-BCP-2018-GB	Proposal Title Surplus Lines Brokers: Surplus Line Advisory Organization
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Equipment	CY	BY	BY +1
<b>Total</b>	\$0	\$0	\$0

## Consulting & Professional Services

External - Subject Matter Expert	\$0	\$2	\$2
<b>Total</b>	\$0	\$2	\$2

## Facility/Capital Costs

<b>Total</b>	\$0	\$0	\$0

## One-Time/Limited-Term Costs Yes ☒ No ☐

Description	BY		BY +1		BY +2	
	Positions	Dollars	Positions	Dollars	Positions	Dollars
OE&E (Std. Complement)	0.0	\$7				
	0.0	\$7	0.0	\$0	0.0	\$0

## Full-Year Cost Adjustment Yes ☐ No ☒

Provide the incremental change in dollars and positions by fiscal year.

Item Number	BY		BY +1		BY +2	
	Positions	Dollars	Positions	Dollars	Positions	Dollars
<b>Total</b>	0.0	\$0	0.0	\$0	0.0	\$0

## Future Savings Yes ☐ No ☒

Specify fiscal year and estimated savings, including any decrease in positions.

Item Number	BY		BY +1		BY +2	
	Positions	Dollars	Positions	Dollars	Positions	Dollars
<b>Total</b>	0.0	\$0	0.0	\$0	0.0	\$0

## (Dollars in thousands)

## Surplus Lines Brokers: Surplus Line Advisory Organization

**Total Special Funds - State Operations** <sup>1</sup>**Total Special Funds - Local Assistance <sup>2</sup>**

<sup>2</sup> Total must tie to "various" funds identified for Local Assistance, Special Funds in the Fiscal Summary.

## **Analysis of Problem**

### **A. Budget Request Summary**

The California Department of Insurance (CDI) is requesting an increase in Special Fund expenditure authority of \$196,000 in Fiscal Year (FY) 2018-19 and \$189,000 in FY 2019-20 and ongoing to support one (1.0) position to comply with the mandates of Assembly Bill (AB) 1641 (Chapter 477, Statutes of 2017).

### **B. Background/History**

California Insurance Code (CIC) Section 1763.1 requires the Commissioner to declare any type of coverage that is not available on the Admitted Market as permissible for placement with a non-admitted insurer by adding that coverage or risk to the Export List maintained by the Commissioner.

The CDI regulates the Surplus Line Insurance Market by licensing Surplus Line Brokers and monitoring the placements made by the Surplus Line Brokers for insurance in that market. The placements in the Surplus Line Insurance Market are governed by CIC Sections 1760 et. seq. The Surplus Line Insurance Market is a market by which Californians can obtain insurance from an insurance company that is not licensed by CDI when the, desired insurance product is not available from the Admitted Market such as a specialized liability contract or the type of risk presented is not a risk written in the Admitted Market such as coverage for vacant buildings, crane operators, or hot air balloon concessions.

Pursuant to CIC Section 1763, the Surplus Line Broker must make a diligent search of the Admitted Market before placing insurance through the Surplus Line Insurance Market. The diligent search means that the Broker seeks to determine if there are at least three (3) Admitted Carriers that write this type of risk/coverage or that three (3) Admitted Carriers have declined to write this particular policy. The Surplus Line Broker must substantiate the diligent search when filing materials for placement with CDI on the Export List.

The Export List helps the Surplus Line Brokers with the diligent search requirement. If an item is on the Export List, then the Surplus Line Broker does not need to perform a diligent search of the Admitted Market and he/she does not have to file the diligent search paperwork when filing materials to substantiate the placement with CDI for the Export List. The Export List saves Surplus Line Brokers time and money and can result in expedited placements in the Surplus Line Insurance Market. Any type of insurance on the Export List is subject to an annual affirmative finding by the Commissioner that there is not a reasonable or adequate market among Admitted Insurers; if determined otherwise, the Commissioner may remove that type of insurance from the Export List. The current Export List has 57 items on the list.

Historically, the CDI has conducted one (1) Export List hearing per year, which has been adequate to address the needs of the market for adding or removing coverages from the Export List. The hearing panel usually consists of one or two (2) CDI staff members, and in some years an Executive staff member has been involved. During the hearings, the panel listens to the presentations made by the Surplus Line Brokerage community, insurers and general public. The Admitted Market of insurers are stakeholders in the Export List Hearing and they may also make presentations at the Export List Hearing regarding products they believe that they provide and that are currently being offered in the Admitted Market. There are currently approximately 1,158 Admitted Carriers in California.

As of the end of 2016, there were approximately 5,192 Surplus Line Brokers that were licensed by the CDI. Of this group, there were approximately 563 Surplus Line Brokers that have made filings for placements on the Export List. The other group of stakeholders that may be impacted is the Surplus Line Insurers and currently there are approximately 241 Surplus Line Insurers that are being used in California. As of 2016, the Surplus Line Insurance Market on the whole in California generates approximately \$5,765,030,542 in premiums.

AB 1641 amends Sections 1763.1 and 1780.52 of the CIC, which:

- Authorizes the Commissioner to declare exempt from the requirements for placement of insurance with a non-admitted insurer the type of coverage that is for new, innovative products for which a reasonable or adequate market among admitted insurers has not had time to develop.
- Authorizes additions to the Export List to be made after a hearing.

## Analysis of Problem

- Authorizes any member of the National Association of Registered Agents and Brokers licensed as a Surplus Line Broker in his, her, or its home state of residence or business and paying the applicable state license fee as members of the surplus line advisory organization if certain conditions are met.

### Legal Branch Resource History (Dollars in thousands)

<sup>1/</sup> Based on Allotments.

Program Budget	FY 2013-14	FY 2014-15	FY 2015-16	FY 2016-17	FY 2017-18 Projected
Authorized Expenditures <sup>1/</sup>	\$15,673	\$17,131	\$19,076	\$20,360	\$20,855
Actual Expenditures <sup>2/</sup>	\$15,697	\$15,906	\$19,064	\$22,092	\$20,855
Authorized Positions <sup>3/</sup>	129.5	132.5	137.0	136.0	138.0
Filled Positions <sup>3/</sup>	116.1	109.7	117.6	125.7	138.0
Vacancies	13.4	22.8	19.6	10.3	0.0

<sup>2/</sup> Based on FM 13 Year-end budget reports.

<sup>3/</sup> Based on Salaries and Wages (7A).

### C. State Level Considerations

This proposal does not affect other state agencies and is consistent with the Commissioner's mission to protect consumers and the mandates set forth in the CIC and amended in AB 1641.

### D. Justification

AB 1641, as chaptered, will increase CDI's workload for administering the Export List process and includes:

#### 1. New Research Required on New Terms

The measure expands the grounds for additions to and removal of coverages from the Export List by an additional category for "new, innovative products for which a reasonable or adequate market among admitted insurers has not had time to develop." This language is not defined in the existing California surplus lines statutes and is not defined in the measure, as a result the Attorney III will need to research and determine how to implement the new terms to ensure that CDI is compliant with the mandates of AB 1641. CDI will prepare a recommendation on additions or deletions to the Export List. The Export List is prepared and distributed to all Surplus Line Brokers and Admitted Carriers and posted to the CDI website.

#### 2. New Research Required After Export List Hearing

After receiving requests to fit into the new criteria for addition to the Export List, the Attorney III will have to research the products to determine if it is truly "new, innovative or not had time to develop." CDI may need to obtain expert information in a particular area or acquire subject matter expertise to determine whether a risk or coverage qualifies under the new terminology. CDI's request includes \$2,000 in FY 2018-19 and ongoing to hire an external subject matter expert to help with this determination. Insurance coverages are varied, and expand across nearly all personal and commercial market segments, so determining when a product is "new" or "innovative" or "whether the Admitted Market has not had time to develop" a similar product, requires specialized knowledge and research. It is critical that CDI has a dedicated resource with proficiency in patent or intellectual property in order to research and determine, whether a product meets the new criteria.

#### 3. Longer Hearings-More Complex Hearings

Historically, the annual Export List hearings took less than one hour to conduct. With the new criteria and the ability to add new product options, as a result of AB 1641, CDI projects that future hearings will increase to approximately eight (8) hours for each hearing in order to hear all the arguments for each product being presented. The Attorney III will need to research and be prepared for the presentations in order to be an active participant in the hearing.

### 4. CDI Presentations at the Export List Hearing

AB 1641 authorizes the Commissioner to put on evidence and propose to add a “new or innovative product, or a product that the Admitted Market has not had time to develop”, on his/her own motion. As a result, the Attorney III will need to research, prepare and make the presentation(s), on the Commissioner’s behalf, at the Export List Hearing which has not occurred previously.

### 5. Time Sensitivity

By adding the new criterion included in AB 1641, it will be critical that CDI has the ability to quickly respond to the market needs. With the addition of an Attorney III, CDI will be able to quickly address inquiries and requests for additions and/or additional hearings to add the necessary new market items to the Export List to facilitate market needs.

### 6. More Complex Additions (Multiple Additions for One Topic Area)

As a result of AB 1641, there may be several additions to the Export List to cover some of the newer topic areas in the industry. Some of the newer product and topics in the surplus line industry are very complex and may require several new listings for a topic area. The Attorney III will need to conduct research on the new topic areas to determine the different types of coverages that are offered in an area and which ones meet the criteria of AB 1641. Examples of possible additions include:

Cyber-Risks or Cyber-Security - Although the industry may talk about “cyber-risks” in general, when products are placed on the Export List, CDI needs to closely define the types of products to be listed. In the area of cyber-risks, there may be as many as 13-20 different types of cyber insurance policies. The CDI will need to research, explore and understand these complex policies and risk types to adequately understand which ones fall under the criteria of AB 1641.

Cannabis - The Export List and Surplus Line Insurance Market is an important option for the Commissioner and to the State of California in order to ensure that there are products available to meet the needs for the cannabis industry. In an article on October 2, 2017, in Business Insurance, the Commissioner stated that he knows that the cannabis insurance is written by many Surplus Line Insurers but no Admitted Insurers. At present, cannabis insurance related products are not listed as products on the Export List, but cannabis insurance products are written in the Surplus Line Insurance Market. Given the recent cannabis developments in the State of California, CDI needs the ability to quickly address the needs of this market as it moves forward to serve the cannabis industry.

Surplus Lines Insurance Market - The Surplus Lines Insurance Market also has offered some innovative products in rideshare, home sharing, and drones industries. California is a state of innovation and with that innovation comes insurance needs. The CDI needs the ability to quickly facilitate the availability of these insurance products on the Export List in order to cover and facilitate the innovation that California is known for.

The most cost-intensive process that CDI will be involved in as a result of this legislation includes more frequent and lengthier hearings to consider increased requests to add or remove coverages from the Export List under the new terms, as well as determining whether a coverage or risk meets the new definition of what is permissible for publication on the Export List. CDI anticipates the Department will hold an additional three (3) hearings a year to address the demand.

The following provides a list of workload items and the time it will take to complete these items:

- Analysis of Export List Addition or Removal Request (Item 1) = 80 hours
- Pre-Hearing Planning Research and Notice (Item 1 and 4) = 160 hours
- Hearing (Item 3) = 8 hours
- Post-Hearing Analysis (Item 2, 5 and 6) = 320 hours
- Issuance of an order (Items 1-6) = 160 hours

Total Hours = 728 hours x 3 hearings / year = 2,184 hours / year

Position Equivalent 2,184 hours divided by 1,778 hours / position = 1.22 position



## Analysis of Problem

To address the increased workload CDI is requesting one (1.0) Attorney III and \$196,000 in Fiscal Year (FY) 2018-19 and \$189,000 in FY 2019-20 and ongoing to comply with the mandates of AB 1641. CDI anticipates the increased workload will materialize as soon as the bill becomes effective January 1, 2018. This is due in part to the current trending expansion of the Surplus Lines Insurance Market and rapidly changing technology that likewise is rapidly shaping insurance products and coverages.

If this budget change proposal is not approved, the Department will not have the resources necessary to properly implement AB 1641. Such lack of resources would prevent CDI from ensuring that new and innovative products are available to consumers based on the up and coming trends in the industry. The resources requested in this budget change proposal are necessary to ensure that the Department does not falter in its primary mission of protecting California's insurance consumers to the full extent of the law.

### E. Outcomes and Accountability

The objective of this proposal is to ensure that CDI has the proper resources to implement the requirements set forth in AB 1641 described above. If this budget change proposal is approved, the Department will have an Attorney III on staff who will be dedicated to developing expertise in the mandates of AB 1641 and ensuring that the Department implements AB 1641 as required by law. CDI will conduct annual program evaluations and continue to monitor the Surplus Line Broker activities to ensure the appropriate use of state resources and funding.

### F. Analysis of All Feasible Alternatives

**Alternative 1** – Approve this request for one (1.0) Attorney III and \$196,000 in Fiscal Year (FY) 2018-19 and \$189,000 in FY 2019-20 and ongoing to comply with the mandates of AB 1641.

#### Pros:

- Provides staff resources to implement AB 1641 in a timely manner, which will ensure CDI is responsive to trends in the industry.
- CDI would have a dedicated resource that possess the required administrative hearing skills and possess some subject matter expertise (i.e. patent or intellectual property law).
- More efficient processing of the hearings, since staff will be able to focus their efforts on the lengthier, additional hearings and determining their outcomes, and not on other matters.

#### Cons:

- Requires an increase to CDI's expenditure authority and authorized State positions.

**Alternative 2** - Absorb workload within existing resources.

#### Pros:

- Does not require an increase to CDI's expenditure authority and authorized State positions.

#### Cons:

- This will limit the number of hearings that could be offered during the year.
- This will limit CDI responsiveness to adding new products on the Export List timely.
- CDI would have to prioritize the filings workload in CAB differently or even put filings on hold resulting in a back-log in CAB workload.

## Analysis of Problem

- Would likely result in delays in the final recommendations for additions and deletions on the Export List.

### **Alternative 3** – Deny the request and do not implement the mandates of AB 1641

#### Pros:

- Does not require an increase to CDI's expenditure authority and authorized State positions.

#### Cons:

- CDI will not have the resources to comply with the mandates of AB 1641.
- CDI will be unable to expand the Export List timely.
- CDI will not be responsive to adding new, innovative products for which a reasonable or adequate market among Admitted Insurers has not had time to develop.

## **G. Implementation Plan**

CDI will start the hiring process no later than April 2018 to ensure the position is filled effective July 1, 2018. The hiring will be contingent upon approval of inclusion of the position in the FY 2018-19 budget.

## **H. Supplemental Information**

	<b>FY 2018-19 and Ongoing</b>
Consulting & Professional Services - External	\$2,000

## **I. Recommendation**

Alternative 1 – This is the only alternative that provides the appropriate level of resources to implement AB 1641 to ensure the CDI is able to quickly respond to changes/trends in the Surplus Lines Insurance market.

Denial of this proposal will not provide the resources necessary to comply with the mandates of AB 1641, which are new and unique, and will limit CDI in its ability to implement the statute properly and timely. Failure to implement the statute, as required, will limit access for consumers because products may not be available timely as market trends change.